

Private foundation; taxable expenditure; educational grants; request for approval. A private foundation submitted a request for approval of its grant-making procedures to the Service, did not receive a reply within 45 days, and considered the procedures to be approved under section 53.4945-4(d)(3) of the regulations.

Later, the foundation was notified by the Service that its grant-making program did not conform to the requirements of section 4945(g) of the Code. After receipt of the disapproval notification, the remaining installments of fixed-sum grants awarded during the period the foundation's procedures were deemed approved are not taxable expenditures; however, the renewals of any grants awarded during such period are taxable expenditures.

#### ISSUE

Are grants made by a private foundation in the two situations described below to grant recipients after the foundation's receipt of notification from the Internal Revenue Service that its grant-making program does not conform to the requirements of section 4945(g) of the Internal Revenue Code taxable expenditures under section 4945(d)(3)?

#### FACTS

A private foundation exempt from federal income tax under section 501(c)(3) of the Code established a program of awarding grants for educational purposes. Before awarding any grants under this program, the foundation properly submitted a request for approval of its grant-making procedures to the Service.

The foundation was not notified within 45 days from the date of the submission of its request that its procedures were not acceptable. As a result, the procedures were considered to have been approved from the date of submission under section 53.4945-4(d)(3) of the regulations on Foundation and Similar Excise Taxes.

#### Situation 1.

The foundation awarded several fixed-sum grants during the period in which its grant-making procedures were deemed approved under section 53.4945-4(d)(3) of the regulations. Payments in satisfaction of each grant were scheduled to be made in installments over a period of time extending past one year. After awarding the grants, but prior to the completion of payments in satisfaction of them, the foundation was notified that its grant-making procedures did not conform to Service requirements. The foundation proposes to pay the remaining installments of the fixed-sum grants.

#### Situation 2.

The foundation awarded several grants during the period in which its grant-making procedures were deemed approved under section 53.4945-4(d)(3) of the regulations. After awarding the grants, the foundation was notified that its grant-making procedures did not conform to Service requirements and that future awards pursuant to these procedures would be taxable expenditures. The foundation proposes to renew some of the grants awarded during the period in which its grant-making procedures were deemed approved under section 53.4945-4(d)(3).

#### LAW AND ANALYSIS

Section 4945 of the Code imposes a tax on each taxable expenditure made by a private foundation.

Section 4945(d)(3) of the Code provides that the term 'taxable expenditures' includes any amount paid or incurred by a private foundation as a grant to an individual for travel, study, or other similar purposes except as provided in section 4945(g).

Section 4945(g) of the Code provides that a grant to an individual for study that is made on an objective and nondiscriminatory basis pursuant to a procedure approved in advance by the Secretary is not a taxable expenditure under section 4945(d)(3) if it is demonstrated to the satisfaction of the Secretary that (1) the grant constitutes a scholarship or fellowship grant which is subject to the provisions of section 117(a) and is to be used for study at an educational organization described in section 170(b)(1)(A)(ii), (2) the grant constitutes a prize or award that is subject to the provisions of section 74(b), if the recipient of such prize or award is selected from the general public, or (3) the purpose of the grant is to achieve a specific objective, produce a report or other similar product, or improve or enhance a literary, artistic, musical, scientific, teaching, or other similar capacity, skill, or talent of the grantee.

Section 53.4945-4(a)(3)(ii) of the regulations provides the general rule for the making of grants that will not be taxable expenditures under section 4945(d)(3) of the Code, and includes the requirement that the grant be made pursuant to procedures approved in advance by the Commissioner.

Section 53.4945-4(a)(3)(iii) of the regulations provides a special rule for the renewal of grants which satisfied the requirements of section 53.4945-4(a)(3)(ii). Generally such renewals are not treated as grants to individuals and subject to the requirements of section 53.4945-4 if: (1) the foundation has no information that the original grant was improperly used; (2) the reports required in the original grant have been furnished; and (3) the foundation's renewal procedures are objective and nondiscriminatory.

Section 53.4945-4(d)(3) of the regulations provides that if,

by the 45th day after a request for approval of grant procedures has been properly submitted to the Service, the organization has not been notified that such procedures are not acceptable, such procedures shall be considered as approved from the date of submission until receipt of actual notice from the Service that such procedures do not meet the requirements of section 4945(g) of the Code. If a grant to an individual for a purpose described in section 4945(d)(3) is made after notification to the organization by the Service that the procedures under which the grant is made are not acceptable, such grant is a taxable expenditure.

#### Situation 1.

In Situation 1 the question is whether payment of the remaining installments of the fixed-sum grants will result in taxable expenditures under section 4945(d)(3) of the Code. Since the grants described in Situation 1 were made during the period that the foundation's procedures were deemed approved, they are not taxable expenditures. Payment of the remaining installments, even after notification by the Service that the procedures were not acceptable, will not be considered to be awarding of new grants but merely the satisfaction of the foundation's obligation under the grants that were deemed approved. Accordingly, paying the remaining installments will not result in taxable expenditures under section 4945(d)(3).

#### Situation 2.

In Situation 2, the question presented is whether a renewal of any grant that the foundation awarded during the period that its procedures were deemed approved under section 53.4945-4(d)(3) of the regulations will result in a taxable expenditure under section 4945(d)(3) of the Code. Unlike the installment payments considered in Situation 1, the grant renewals considered in Situation 2 are within the discretion of the foundation and are in essence new grants. Section 53.4945-4(a)(3)(iii) of the regulations provides a simplified procedure for renewals when the full and proper grant-making procedures have been followed in making the original grant. This section recognizes that it would be burdensome and unnecessary for the foundation to repeat the original grant-making procedures for every renewal unless it has knowledge that the original grant was misused or that the requirements of the original grant have not been met. The simplified procedure is available, however, only when the requirements for an original grant, as set forth in section 53.4945-4(a)(3)(ii), have once been met. Therefore, once the Service has determined and notified the foundation that its grant-making procedures are defective, any renewal grants awarded after receipt of that notice would be taxable expenditures under section 4945(d)(3).

#### HOLDINGS

In Situation 1, the payment by the foundation of the

remaining installments of fixed-sum grants awarded during the period the foundation's procedures were deemed approved under section 53.4945-4(d)(3) of the regulations, after the foundation's receipt of notification from the Service that its grant-making program does not conform to the requirements of section 4945(g) of the Code, are not taxable expenditures under section 4945(d)(3).

In Situation 2, the renewals of any grants that the foundation awarded during the period that its procedures were deemed approved under section 53.4945-4(d)(3) of the regulations, after the foundation's receipt of notification from the Service that its grant-making program does not conform to the requirements of section 4945(g) of the Code, are taxable expenditures under section 4945(d)(3).